

Message Text

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SUBJECT: SITUATION REPORT, NOVEMBER 5

REF: A. STATE 267168 B. LONDON 17728

1. GOVERNMENT LOSES TWO BY-ELECTIONS: THE CONSERVATIVE PARTY WON TWO OF THREE TRADITIONALLY SAFE LABOR SEATS IN THE NOVEMBER 4 PARLIAMENTARY BY-ELECTIONS. THIS OUTCOME IS SOLID EVIDENCE OF POPULAR DISSATISFACTION WITH THE GOVERNMENT AND THE CURRENT ECONOMIC SITUATION. EVEN THOUGH THE GOVERNMENT'S WORKING MAJORITY IN PARLIAMENT HAS BEEN WHITTLED TO A SINGLE SEAT, LABOR STILL ENJOYS A 34-SEAT ADVANTAGE OVER THE TORIES AND IS DETERMINED TO REMAIN IN POWER. AS THE LIBERAL PARTY ALSO DID POORLY IN THE BY-ELECTIONS, WE DO NOT BELIEVE THIS DEVELOPMENT ENHANCES THE PROSPECTS FOR AN EARLY GENERAL ELECTION.

2. STERLING BALANCES: FOLLOWING UP ON THE NOVEMBER 4 SITUATION REPORT ON NEDC COUNCIL (PARA 2 OF LONDON L7728), THE DAILY EXPRESS REPORTED THAT WHITEHAL PLANS FOR A BIG AMERICAN BAIL-OUT OF THE BRITISH ECONOMY WERE CAST INTO LIMBO BY JIMMY CARTER'S ELECTION
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VICTORY. ACCORDING TO THE ARTICLE, PRIME MINISTER

CALLAGHAN TOLD THE NEDC MEETING THAT THERE MIGHT BE A DAMAGING PERIOD OF DELAY AND UNCERTAINTY WHILE THE NEW WHITE HOUSE ADMINISTRATION TAKES OVER. LONDON FEELS A DELAY OF SEVERAL MONTHS BEFORE THE NEW PRESIDENCY GETS INTO ITS STRIDE COULD MEAN LOSING SOME MOMENTUM. MR. CALLAGHAN HAD HOPED THAT THE IMF LOAN COULD BE SETTLED THIS MONTH SO THAT TALKS COULD BEING AT ONCE ON A BIGGER OPERATION TO FUND STERLING. A HOPEFUL SIGN, ACCORDING TO THIS PRESS REPORT, IS THAT PRESIDENT-ELECT CARTER SEES THE POTENTIAL FINANCIAL CRISIS AS A MATTER FOR URGENT ATTENTION; HE HAS ALREADY ACCEPTED AN INVITATION FROM OUTGOING TREASURY SECRETARY SIMON TO BE BRIEFED ON MEASURES TO SUPPORT BRITAIN.

THIS MORNING'S FINANCIAL TIMES HAS ARTICLES BY SAM BRITTAN THAT THE BIS WILL DISCUSS STERLING BALANCES THIS WEEKEND AND NEXT MONDAY AND TUESDAY. GORDON RICHARDSON, GOVERNOR OF THE BANK OF ENGLAND IS BOUND TO BE ASKED WHAT BRITAIN'S HOPES AND INTENTIONS ARE CONCERNING TACKLING STERLING BALANCES. CHANCELLOR HEALEY IS EXPECTED TO FACE SIMILAR INTERROGATION AT THE EC FINANCE MINISTERS' MEETING IN BRUSSELS ON MONDAY. ACCORDING TO BRITTAN, WHO HAS JUST VISITED CONTINENTAL CENTRAL BANKERS, SOME WOULD LIKE TO SEE AN AGREEMENT OR AT LEAST A STATEMENT OF INTENT ON THE STERLING BALANCES AS SOON AS POSSIBLE AFTER THE IMF STANDBY HAS BEEN AGREED IN DECEMBER. SOME THINK THE TWO AGREEMENTS SHOULD BE RATIFIED AT THE SAME TIME. ANOTHER SCHOOL OF THOUGHT WOULD PREFER A WIDER DIS-

/
CUSSION OF THE BRITISH ECONOMY PERHAPS AT A SUMMIT LEVEL WHEN JIMMY CARTER'S ADMINISTRATION HAS TAKEN OFFICE.

THE TWO MAIN WAYS OF TACKLING BALANCES ARE SEEN TO BE A CONVERSION INTO LONG TERM BONDS OR A STANDBY FACILITY TO REIMBURSE THE UK FOR STERLING BALANCE WITHDRAWALS, SIMILAR IN APPROACH TO THE EARLIER BASLE AGREEMENT WHICH LAPSED IN 1974. CENTRAL BANKING LIMITED OFFICIAL USE

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OPINION IN MANY EUROPEAN COUNTRIES IS STRONGLY IN FAVOR OF A NEW BASLE-TYPE AGREEMENT. THEY FORESEE DIFFICULTIES ABOUT THE ISSUE OF LONG-TERM BONDS. BRITTAN ADDS THAT THERE ARE SOME OVERSEAS CENTRAL BANKERS WHO SHARE THE H.M. TREASURY VIEW THAT ONCE THE IMF STANDBY HAS RESTORED CREDIBILITY, THE BEST WAY OF MANAGING ANY CURRENT PAYMENTS DIFFICULTIES WOULD BE THROUGH THE EXISTING NATIONALIZED INDUSTRY SCHEME FOR

BORROWING ON THE EURODOLLAR MARKET, BUT THERE ARE OTHERS WHO NOTE THAT GOVERNMENT-TO-GOVERNMENT LOANS MIGHT HAVE LONGER MATURITIES, LOWER INTEREST RATES AND, ABOVE ALL, BE A PRACTICAL DEMONSTRATION OF CONCERN FOR

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THE POLITICAL FUTURE OF BRITAIN.

3. JOEL BARNETT, MP AND CHIEF SECRETARY OF THE TREASURY, IN A SPEECH LAST NIGHT SAID SEVERE CUTS IN PUBLIC SPENDING WILL NOT BE CARRIED OUT BY THE TREASURY BUT THAT THERE IS ROOM FOR RE-EXAMINATION OF THE HEAVY COST OF TRANSFER PAYMENTS SUCH AS SOCIAL SECURITY BENEFITS. BARNETT ALSO SAID HE WANTED TO SEE INCOME TAX WHICH AT HIGHER RATES WAS SQUEEZING MIDDLE AND UPPER MANAGEMENT COME DOWN, BUT WITH THE CURRENT BORROWING REQUIREMENTS, THERE WAS NO IMMEDIATE POSSIBILITY OF SIGNIFICANT CUTS IN INCOME TAXES.

4. GOVERNMENT PUSHES LEGISLATIVE PROGRAM: LEADER OF THE HOUSE OF COMMONS MICHAEL FOOT NOVEMBER 4 ANNOUNCED THE GOVERNMENT WILL SEEK PASSAGE OF AN OMNIBUS CLOTURE MOTION ON FIVE CONTENTIOUS LEGISLATIVE MEASURES DUE TO BE RETURNED TO COMMONS FROM THE HOUSE OF LORDS. THE VOTE ON CLOTURE WILL BE HELD NOVEMBER 8, AND OPPOSITION

PARTIES HAVE DECLARED THEIR INTENTION TO OPPOSE IT. WITH THE GOVERNMENT'S WORKING MAJORITY CUT TO A SINGLE SEAT BY YESTERDAY'S BY-ELECTIONS, THE OUTCOME IS EXPECTED TO BE EXTREMELY CLOSE. SHOULD THE GOVERNMENT LOSE ON THIS PROCEDURAL ISSUE, ITS PROSPECTS FOR SALVAGING ITS LEGISLATIVE PROGRAM WOULD BE SLIM, LIMITED OFFICIAL USE

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THOUGH WE UNDERSTAND CALLAGHAN IS PREPARED TO CONTINUE THE CURRENT SESSION OF PARLIAMENT IN AN ATTEMPT TO OBTAIN PASSAGE OF ITS PROGRAM. IF, ON THE OTHER HAND, THE GOVERNMENT WINS ON CLOTURE, IT SHOULD BE ABLE TO GET MOST OF THE PENDING LEGISLATION THROUGH.

IT SHOULD BE NOTED THAT THE GOVERNMENT'S SUCCESS OR FAILURE ON THE GUILLOTINE AND ON ITS CURRENT LEGISLATIVE PROGRAM HAS NO DIRECT RELEVANCE TO THE RECEPTION PARLIAMENT MAY GIVE TO THE PROSPECTIVE "ECONOMIC PACKAGE".

5. IN A SPEECH TO A BUSINESS GROUP IN LONDON NOVEMBER 4, ROY JENKINS, THE PRESIDENT-DESIGNATE OF THE EUROPEAN COMMISSION, BLAMED FLOATING EXCHANGE RATES FOR THE INDISCIPLINE OF GOVERNMENT POLICY AND BRITAIN'S ECONOMIC PREDICAMENT. HE FELT THAT THE TRAUMA OF OCCASIONAL "STEP" DEVALUATIONS WOULD PRODUCE BETTER DISCIPLINE. THE EEC MIGHT OVER THE NEXT DECADE BE TORN APART UNLESS THE PRESENT DIVERGENCE OF ECONOMIC PERFORMANCE AND EXCHANGE RATE TRENDS WAS REVERSED.

6. A THIRD ROUND OF WAGE POLICY: WHILE THE TUC HAS LIMITED ITSELF TO SUGGESTING "AN ORDERLY AND PHASED RETURN TO FREE COLLECTIVE BARGAINING" WHEN THIS YEAR'S WAGE POLICY RUNS ITS COURSE ON AUGUST 1, CBI DIRECTOR-GENERAL JOHN METHVEN, IN HIS OPENING PUBLIC FORAY ON THE SUBJECT YESTERDAY (NOV 4), CAUTIOUSLY SUGGESTED A 7 PERCENT WAGE LIMIT IN THE NEXT ROUND, WHICH IN HIS VIEW IS ESSENTIAL IF BRITAIN IS TO REDUCE INFLATION TO BETWEEN 5 AND 7 PERCENT IN 1978. IN METHVEN'S VIEW, THE NEXT WAGE ROUND SHOULD BE MORE FLEXIBLE, AND THE 7 PERCENT FIGURE WOULD INCLUDE CONSOLIDATION INTO BASIC WAGE RATES OF THE FLAT WAGE RATES IN FORCE DURING THE FIRST TWO YEARS OF WAGE RESTRAINT, THE RESTORATION OF DIFFERENTIALS ERODED SINCE MID-1975 AND THE CORRECTION OF PAY ANOMALIES OR DISTORTIONS WHICH DEVELOPED DURING THE PAST TWO YEARS. METHVEN'S SUGGESTION IS NOT A FINAL CBI POSITION, AND, IN FACT, PUBLIC SPARRING LIMITED OFFICIAL USE

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ON THE SUBJECT IS JUST BEGINNING.

7. OIL PRODUCT PRICES INCREASE: IMPACT OF STERLING DEVALUATION ON DOLLAR-BASED COSTS OF UK OIL REFINERS AND MARKETERS HAS BEEN SUBSTANTIAL THROUGHOUT L976. GOVERNMENT HAS APPROVED FUEL AND PETROL PRICES INCREASES THREE TIMES THUS FAR AND A FOURTH ROUND CAN BE EXPECTED BY YEAR END UNLESS THERE IS A SHARP IMPROVEMENT IN THE EXCHANGE RATE. THE LATEST PETROL INCREASE, APPROVED ONLY DAYS AGO, RANGES FROM 2 TO 4 PENCE AND RAISES "4 STAR" PREMIUM TO 82 PENCE PER IMPERIAL GALLON. INDUSTRY IS CONCERNED THAT ADDITIONAL INCREASES WILL OCCUR IN L977 AS A RESULT OF ANOTHER SUBSTANTIAL OPEC CRUDE OIL PRICE INCREASE WIDELY ANTICIPATED TO BE APPROVED AT DECEMBER 15 MINISTERIAL.

8. LABOR DEVELOPMENTS: DESPITE PRESSURE FROM TEXTILE

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AND OTHER UNIONS AND DIRECT INTERVENTION BY THE TUC'S MOST POWERFUL LEADER. JACK JONES, IT APPEARS UNLIKELY THAT COURTAULDS WILL RECONSIDER A CLOSURE PROGRAM, WHICH INVOLVES THE SHUTTING DOWN OF SIX OF ITS BRANCHES AND THE LOSS OF ABOUT 3,700 JOBS. AN ADDITIONAL FACTORY, AT AINTREE, MAY BE SPARED IF PRODUCTIVITY IMPROVES. TRADE UNION AND POLITICAL PRESSURE WILL CONTINUE IN AN EFFORT TO DISSUADE COURTAULDS' FROM TAKING DRASTIC ACTION.

9. A LEFT-WINGER, BOB WRIGHT, HAS BEEN ELECTED ASSISTANT GENERAL SECRETARY OF BRITAIN'S SECOND LARGEST UNION, THE AMALGAMATED UNION OF ENGINEERING WORKERS. WRIGHT, WHO HAS 35 YEARS' EXPERIENCE AS A UNION OFFICIAL, DEFEATED A RIGHT-WINGER, JOHN WEAKLEY. IN A SERIES OF ABOUT 20 ELECTIONS FOR OTHER UNION POSTS, MODERATES HELD THEIR GROUND AND ONE WELL-KNOWN LEFT-WINGER, JIMMY REID (WHO RECENTLY QUIT THE COMMUNIST PARTY) WAS ALSO DEFEATED BY A RIGHT-WINGER. WHILE WRIGHT'S ELECTION IS IMPORTANT IN THAT IT PUTS HIM IN LINE FOR CONTENTION FOR THE CRITICAL PRESIDENTIAL POST WHEN HUGH SCANLON RETIRES IN TWO YEARS TIME, IT DOES NOT APPEAR TO SIGNAL A REVERSE IN THE TREND TOWARDS MODERATE VICTORIES IN MANY UNION ELECTIONS WHICH HAS BEEN THE CASE FOR MORE THAN A YEAR. WRIGHT, LIMITED OFFICIAL USE

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THOUGH A LEFT-WINGER, IS A RESPECTED TRADE UNIONIST AND SOME OF HIS SUPPORT WAS CLEARLY A "SYMPATHY VOTE".

10. IMPORTS: FOREIGN PENETRATION OF THE U.K.'S AUTO-MOBILE MARKET CONTINUED AS IMPORTS GREW TO 42 PERCENT OF THE MARKET IN OCTOBER. THE THIRD CONSECUTIVE MONTH IN WHICH THE SHARE OF IMPORTS STOOD GREATER THAN 40 PERCENT. PENETRATION IN OCTOBER 1975 WAS 38 PERCENT. THIS INCREASE REFLECTS, AMONG OTHER THINGS, FORD'S SHIFT TO PRODUCING CERTAIN MODELS IN GERMANY, WHICH HAS MOVED FORD INTO SECOND PLACE BEHIND DATSUN AS A U.K. CAR IMPORTER. (FORD'S MOVE WAS MADE, IN PART, TO FREE U.K. ASSEMBLY FACILITIES TO MANUFACTURE A NEW LINE.)

11. FINANCE AND FOREIGN EXCHANGE: STERLING MOVED UP STRONGLY IN TRADING ON THURSDAY, NOVEMBER 4. THE POUND OPENED AT \$1.6100, AND MOVED TO \$1.6410 IN MID-AFTERNOON BEFORE EASING TO \$1.6260 AT THE CLOSE. FORWARD RATES CONTINUED TO NARROW SHARPLY, THE THREE-MONTH FORWARD DISCOUNT ON STERLING CLOSING AT 4.47 CENTS WHICH REPRESENTS AN ANNUALIZED COST OF FORWARD COVER OF 10.55 PERCENT. TWO RUMORS WERE CURRENT IN

THE MARKET: THE FIRST WAS THAT A NEW FINANCIAL PACKAGE TO REDUCE THE PUBLIC SECTOR DEFICIT WOULD BE SHORTLY PREPARED; THE SECOND THAT LARGE DM SPECULATIVE POSITIONS WERE BEING UNWOUND. ALL THE CONTINENTAL CENTERS CONTRIBUTED TO THE RISE IN STERLING. STERLING'S STRENGTH CONTINUED ON FRIDAY MORNING AS THE POUND TRADED NEAR \$1.64.

NOTE: SIT REP NOV 4 PARAGRAPH 3 SHOULD BE CORRECTED. SIXTH SENTENCE SHOULD READ: "THIS NARROWING BRINGS THE ANNUALIZED COST OF FORWARD COVER DOWN FROM 14.28 TO 13.28 PERCENT."

A SURGE OF PURCHASES ON THURSDAY MORNING EXHAUSTED THE LONG, 1998 15-1/2 PERCENT, AND SHORT,

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1979A 11-1/2 PERCENT, TAP STOCKS AND BROUGHT GAINS THROUGHOUT THE GILT MARKET DURING THE REST OF THE DAY. GAINS EXTENDED TO 1-3/8 AT THE LONGER END OF THE MARKET, YIELDS FALLING AROUND 0.5 PERCENT IN THE LONGS. THE GILT MARKET OPENED STRONG ON FRIDAY, REGISTERING SMALL GAINS ACROSS ALL MATURITIES.

THE STOCK MARKET ON THURSDAY CONTINUED TO IMPROVE, IN TANDEM WITH THE MOVEMENT IN THE GILT MARKET

THE FINANCIAL TIMES INDEX OF 30 INDUSTRIAL ORDINARY
EQUITIES REACHED 301/1 UP FROM WEDNESDAY'S 290.3
LEVEL. EQUITY PRICES ADVANCED AS WELL IN EARLY
THURSDAY TRADING.

12. GOVERNMENT INCREASES ESTIMATE OF 1977 NORTH SEA
OIL PRODUCTION: LATEST ANNUAL REPORT OF DEPARTMENT
OF ENERGY FORECASTS THAT 1977 NORTH SEA OIL PRO-
DUCTION COULD REACH 45 MILLION TONS, THE EQUIVALENT
OF CLOSE TO 50 PERCENT OF CURRENT ANNUAL CONSUMPTION.
PREVIOUS ESTIMATES FOR 1977 OUTPUT WERE 35-45 MILLION
TON RANGE. REVISED ESTIMATE FOLLOWS ANNOUNCEMENT
SEVERAL WEEKS AGO THAT PRODUCTION FROM BP FORTIES
FIELD WILL BE 25 PERCENT HIGHER THAN ANTICIPATED.

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